

**IN THE MATTER OF THE APPLICATION REGARDING CONVERSION
OF PREMIERA BLUE CROSS AND ITS AFFILIATES**

Washington State Insurance Commissioner's Docket # G02-45

PRE-FILED DIRECT TESTIMONY OF:

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INTRODUCTION AND CREDENTIALS

Q. Please state your name, employer, and business address.

A. My name is Alan Smit, and I work for Premera Blue Cross (“Premera” or the “Company”) at the Company’s Washington Headquarters located at 7001, 220th Street S.W., Mountlake Terrace, Washington 98043-2124.

Q. What is your position with Premera?

A. I am the Chief Information Officer and a Senior Vice President.

Q. Please summarize your educational background.

A. I graduated from Augustana College with a Bachelors of Arts in Business Administration and Accounting in 1974. I also received a Masters in Business Administration from the University of South Dakota in 1975. I received a Certificate of Public Accounting in 1977.

Q. Please discuss your relevant employment prior to working at Premera.

A. Prior to joining Premera in June 1997, I was the Vice President of Corporate Information Systems with Trigon Blue Cross Blue Shield in Richmond, Virginia. Prior to joining Trigon, I was a Senior Consulting Manager with Andersen Consulting, now Accenture, in Atlanta, Georgia.

Q. What are your responsibilities as the Senior Vice President, Chief Information Officer?

A. I am the individual responsible for managing Premera’s information technologies and business systems, including the delivery of new applications of technology in support of the corporate business strategy. Also, I currently serve as the Chair of the Blue Cross Blue Shield Association Inter-plan Technology Advisory Committee. Finally, I represent Premera as a founding participant and Board member of OneHealthPort, a community organization dedicated to offering healthcare providers a secure portal to the online services offered by leading local health organizations.

SUMMARY OF TESTIMONY

Q. Could you briefly summarize the substance of your testimony?

A. In today's marketplace, a variety of factors are requiring healthcare organizations to invest in technology at an accelerated rate. These factors include the competitive forces and expectations within the marketplace, industry trends to Information Technology ("IT") integration and connectivity, and responses to legislative and regulatory requirements.

Sophisticated IT is not an option in the healthcare industry—it is a competitive necessity. All healthcare insurers continue to invest more heavily in IT to provide more choice and service, enabling them to compete more effectively for potential customers. The market compels Premera, as an industry competitor, to offer the same or better choice and service to compete for business and, eventually, consumers come to expect these options as part of baseline packages. As one set of IT functionality becomes "industry standard," insurers develop an entirely new set of functionality to continue to meet the next set of consumer expectations—in other words, once all competitors reach an equal IT footing, the bar is raised.

Other challenges face Premera and the marketplace in general. System integration—securely connecting insurers with hospitals, clinics, pharmacists, etc.—is a significant challenge for a marketplace that has been technologically fragmented. This trend, which is driven by market evolution, available technology, and regulatory requirements, is viewed as one of the primary means to improve quality and contain industry costs. Thus, while integration may have substantial medium to long-term benefits, it is a significant undertaking requiring continued future investment.

These IT demands are challenging the industry financially. Gartner Dataquest forecasts that IT spending in the U.S. healthcare market will increase at a compound annual growth rate (CAGR) of 7 percent from \$34.1 billion in 2001 to \$47.9 billion in 2006. Compared with other United States industries, healthcare is the second-fastest-

1 growing market for IT, surpassed only by the government sector.¹ In fact, according
2 to a Cap Gemini Ernst & Young study, today's managed care organizations "are in a
3 state of transition and are automating their operations at unprecedented levels."²
4 Premera's firsthand experience mirrors that of the healthcare IT industry. Premera
5 nearly doubled its IT spending over the last four years and we believe this increased
6 level of spending will need to be maintained during the foreseeable future.

COMPETITIVE FORCES AND MARKET EXPECTATIONS

7 **Q. Why do competitive forces and market expectations require Premera to**
8 **increase its spending on technology?**

9 A. As a healthcare insurer, Premera competes with other health plans (Regence,
10 Aetna, United, Cigna, etc.) for potential members wishing to purchase an insurance
11 policy. In my role as CIO I have read customers' requests for proposal ("RFPs"),
12 reviewed Blue Cross Blue Shield Association and other industry market research, and
13 participated in the formulation and execution of the company's corporate strategy. I
14 have found that prospective customers consider a variety of factors when making a
15 buying decision. In addition to price, customers consider the following: the flexibility
16 of the offered product; the accessibility of health, membership, and claim
17 information; and the responsiveness to service inquiries and requests. In my view, IT
18 is an integral part of providing the choices, access, and service customers expect.

19 Let me give you an example. In the decades prior to 2000, in response to the
20 constantly evolving healthcare marketplace, Premera repeatedly augmented its
21 applications and technology portfolio. As this technology portfolio expanded, it
22 became increasingly more difficult to provide consistent core business practices to the
23 company's stakeholders. Legacy systems, although designed and built using the best

24 ¹ "In Unforgiving Times, the U.S. Healthcare Market Boosts IT Spending, 2001-2006," Gartner
Dataquest, August 2003, at p. 1 (Exhibit 1).

² "Managed Care Measures, Results of the 2002 Managed Care Benchmarking Study" Cap Gemini
Ernst & Young, May 2003, p. 2, located at
http://www.us.cgey.com/downloadlibrary/files/Health_2002MC_BM_Study.pdf.

1 design techniques of their time, were becoming increasingly rigid and incapable of
2 rapid change. As such, to accommodate and support the Company's multi-year
3 company-wide Dimensionstm initiative, which provides insurance buyers and
4 healthcare consumers more choices and a greater involvement in their healthcare
5 programs, Premera decided it needed to replace its legacy systems by implementing a
6 new system technology that could unify critical business functions such as
7 membership enrollment, claims adjudication, and customer service across all products
8 and markets. This system was needed to allow the elimination of redundant
9 processing systems, simplify health plan administration, and integrate e-business and
10 operating processes to enhance service. Premera purchased the TriZetto Facets health
11 plan application to realize these objectives. With the availability of the Facets
12 software, Premera Dimensions customers may also separately choose their provider
13 network and benefits, based on what is important to them – for example, cost,
coverage level, or degree of choice.

14 Similarly, customers have expectations regarding access to information and
15 service—that it be available twenty-four hours a day, seven days a week, and that it
16 provide more meaningful and member-specific information. These expectations are
17 set, in part, as a result of customers' exposure to automation in the retail and financial
18 industries. These expectations have resulted in our investing in the development of
19 considerable web-based services. Consequently, today, members are able to
20 complete numerous tasks online, including: searching for information about providers
21 in Premera's Provider Directory; inquiring regarding general health topics (e.g.,
22 children's health) and medical conditions (e.g., diabetes); obtaining answers to the
23 frequently asked questions about their health plan; and verifying their eligibility,
24 claim, and network status.

To date, in total, we have spent approximately \$125 million on our
Dimensions initiative and web-based services. And, to continue meeting these

1 expectations, Premera will constantly need to update, modify, and improve its IT
2 systems and infrastructure.

3 **Q. Could Premera compete for business without providing these extra
4 services?**

5 A. In Premera's competitive environment, IT-based services are not viewed as
6 extra services. These services and functionalities are a requirement to compete in the
7 marketplace.

8 Another example might help. Premera continually invests in its computer
9 software to increase the number of member claims that can be adjudicated
10 automatically, without manual intervention, to lower administrative costs, allowing
11 the Company to compete on price. Premera's e-business constituent portals provide
12 the Company's stakeholders (our members, providers, employers, and agents) with
13 24/7 web-based access and self-service, permitting the Company to compete in the
14 marketplace on service. And, Premera's investment in business intelligence tools and
15 data warehousing infrastructure assist the Company in converting information into
16 actionable knowledge, allowing the company to compete on value.

17 It is clear our competitors are responding to the price, service, and value
18 marketplace dynamic: within the past two years Cigna implemented a reported billion
19 dollar IT transformation to replace its legacy systems. The Regence Group is also in
20 the process of a large and complex claims and membership system implementation.
21 The fact that our competitors have, or are trying to develop, a high level of IT
22 sophistication makes the environment more challenging. Our competitors and
23 marketplace expectations are pushing us to upgrade, develop, and/or acquire new
24 systems like e-business, workflow automation, and knowledge management to keep
pace with the features customers are expecting and to differentiate ourselves from the
competition.

INDUSTRY TRENDS TO INTEGRATION AND CONNECTIVITY

Q. How will industry trends to integration and connectivity affect Premera's investment in technology?

A. As mentioned earlier in my testimony, the healthcare delivery and financing marketplace is fragmented, resulting in participants (i.e., health plans, hospitals, physicians, etc.), operating relatively autonomous IT systems. To date, these groups have focused on increasing their own organizational investments in IT. The next logical step and industry trend is for these organizations to integrate and connect across market segments by providing access to and sharing clinical and financial information. This integration and connectivity trend is viewed as the best way to improve the quality and control the cost of healthcare.

For example, the Santa Barbara County Care Data Exchange™ is a community-wide initiative designed to improve the quality, efficiency, and safety of health care in Santa Barbara County in California. It accomplishes these designs by making inter and intra-organizational, patient-specific information more readily available at the point of care. To date, the Santa Barbara County initiative has demonstrated that health information exchange is organizationally and technically feasible. It also appears to be sustainable because the data exchange creates a positive financial return for all participating constituents. Studies are currently underway to confirm the quality improvement of care delivery.

As a local leader in the industry, Premera has taken, and is expected to continue to take, a leadership role in making this type of IT integration and connectivity a reality.

Q. Please provide a few examples of the investments Premera has or will need to make to support integration and connectivity requirements.

A. Premera developed a secure self-service Internet portal for providers, allowing them to verify eligibility and benefits and review claim status. However, to simplify access, providers have asked for "all-payer" capabilities. All-payer capabilities

1 means, in essence, that providers have a single way to access all payers. In response
2 to this request, we worked with Siemens Pointshare, a healthcare services vendor, to
3 integrate our online eligibility inquiry capability with Pointshare's all-payer portal,
4 giving providers the choice of coming directly to Premera's website or using
5 Pointshare's solution.

6 In addition, Premera was an investor in and one of the founding organizations
7 of OneHealthPort. OneHealthPort is an online community security portal that makes
8 it easy for physicians, other clinicians, practice administrators, hospital staff and
9 others to access online resources without the need for multiple logons, registrations
10 and paperwork. After investing in OnHealthPort, the Company also invested in its
11 own internal e-business software in order to integrate with the OneHealthPort portal.

12 Finally, Premera partnered with Medco Health Solutions, Inc., our pharmacy
13 benefits manager, to assist in sharing the appropriate member and benefit information
14 with pharmacies. As Premera enrolls new members, it automatically notifies Medco,
15 passing along relevant member and benefit package information which Medco then
16 makes available to the pharmacies serving these members.

17 **LEGISLATIVE REQUIREMENTS**

18 **Q. How have legislative and regulatory requirements affected Premera's**
19 **information technology investment?**

20 A. Obviously, legislative and regulatory requirements have played, and will play,
21 a significant role in the need to continue our increased level of IT spending. To date,
22 the healthcare industry has not achieved the same level of standardization and
23 business-to-business connectivity as the retail and financial industries. This is
24 primarily due to the complexity of healthcare transactions combined with the
disparate levels of technology in place at the various organizations in healthcare
system (e.g., large hospitals, small medical clinics, pharmacies, etc.).

The Federal government enacted the Health Insurance Portability and
Accountability Act of 1996 ("HIPAA"), which imposed standards in an effort to

1 streamline electronic healthcare transactions, while at the same time ensuring the
2 integrity, confidentiality, and availability of individually identifiable health
3 information. HIPAA contains numerous provisions, including the following:

- 4 • “Privacy Standards” that control the use of identifiable patient data within
5 healthcare organizations and govern information disclosure to others. The
6 compliance deadline for this standard was April 14, 2003.
- 7 • The “Electronic Transactions and Code Sets Standards,” which provide uniform
8 coding requirements for claims and other healthcare data transmitted between
9 providers, payers, and employers. The compliance deadline for this standard
10 was October 16, 2003.
- 11 • “Security Standards” that ensure the integrity, confidentiality, and availability
12 of identifiable electronic patient data whether that information is stored or
13 transmitted. The compliance deadline for this standard is April 20, 2005.

14 Compliance with HIPAA’s Privacy and Electronic Transactions and Code
15 Sets standards, which included entirely new mandates regarding how data is stored,
16 transferred, and shared resulted in a myriad of modifications to Premera’s systems.
17 In fact, Premera was required to do more than simply modify its own systems to
18 comply with HIPAA, it also needed to ensure that its systems properly interfaced with
19 other entities’ systems at a time when these entities were modifying, replacing, and/or
20 updating their own systems to comply with this act. While this activity may be
21 beneficial to the extent it leads to increased market-wide integration, it was an
22 enormously costly undertaking for both Premera and the industry. In fact, the
23 department of Health and Human Services estimated that the healthcare industry’s
24 HIPAA implementation costs could be as high as \$17.6 billion.³ Meanwhile,
Premera’s HIPAA implementation cost, to date, is in excess of \$34 million. And,
because some HIPAA requirements are not yet in effect, like the Security Standards,
this spending will last for several more years.

³ U.S. Department of Health and Human Services, “HHS Fact Sheet,” (May 9, 2001), p. 4, located at <http://aspe.hhs.gov/admsimp/final/pvcfact2.htm>

1 Further, large IT investments are likely to be needed in the future as a result of
2 other government mandates. The Department of Health and Human Services
3 (“HHS”) is currently considering a change from the International Classification of
4 Diseases – 9th Edition (ICD-9) coding system to an updated ICD-10 version. The
5 ICD-9 coding system is used for medical diagnosis coding for morbidity purposes in
6 all healthcare settings and procedural coding in the hospital inpatient setting. If HHS
7 requires this change, its implementation, like that of HIPAA, will significantly affect
8 Premera’s systems, requiring additional large investments in IT. In fact, the Blue
9 Cross and Blue Shield Association estimates the potential industry cost of
10 implementing the ICD-10 coding system to be as high as \$2.1 billion for health plans
11 and up to \$14 billion industry wide.⁴ This study also estimates spending during the
12 two to three year adoption period would be much costlier than the healthcare
13 industry’s implementation of Y2K modifications.

14 Another example is Congressman Patrick Kennedy’s proposed “Quality,
15 Efficiency, Standards, and Technology for Healthcare Transformation” (QUEST) act
16 which calls for a “number of structural changes that would reduce duplication,
17 eliminate errors from clinical support software, foster establishment of best practice
18 guidelines for providers, give public health agencies a way to rapidly detect and
19 respond to bio-terrorism threats, provide data to measure and repair provider
20 performance, and cut down on administrative costs such as transcription and billing.”⁵

21 An additional example is the National Committee on Vital and Health
22 Statistics, which is a public advisory committee statutorily authorized to advise the
23 Secretary of HHS on national health information policy. It has proposed a voluntary
24 10-year process to build a “National Health Information Infrastructure,” comprised of

⁴ “BCBSA Study Reveals Coding Shift Could Cost Healthcare Industry Up To \$14 Billion”, BCBS
HealthIssues.com, October 2003, located at
[http://vocuspr.vocus.com/VocusPR30/DotNet/Newsroom/Query.aspx?SiteName=BCBSA&Entity=PR
Asset&SF_PRAsset_PRAssetID_EQ=72238&XSL=PressRelease&Cache=](http://vocuspr.vocus.com/VocusPR30/DotNet/Newsroom/Query.aspx?SiteName=BCBSA&Entity=PRAsset&SF_PRAsset_PRAssetID_EQ=72238&XSL=PressRelease&Cache=).

⁵ “Kennedy to offer HIT bill”, HealthcareITNews, March 2004, located at
<http://www.healthcareitnews.com/NewsArticleView.aspx?ContentID=312>.

1 a set of technologies, standards, applications, systems, values, and laws that support
2 all facets of individual health, health care, and public health.

3 What does seem clear is that legislative and other government mandates
4 requiring large IT investment are likely in the future.

5 **PREMERA TECHNOLOGY SPENDING**

6 **Q. How have these factors affected Premera's actual and projected spending
on technology?**

7 A. Premera nearly doubled its IT spending over the last four years and we believe
8 this increased level of spending will need to be maintained during the foreseeable
9 future.

10 Premera has been a leader in implementing IT solutions to meet the needs of
11 its members. In October 2003, the Government Accounting Office ("GAO") did a
12 survey of information health plan technology producing a report prepared for the
13 U.S. Senate Committee on Health, Education, Labor, and Pensions titled
14 "Information Technology Benefits Realized for Selected Health Care Functions". In
15 their report, the GAO made the following observation about Premera: "Premera has
16 invested heavily in technologies to better capture, cleanse, and manage information in
order to assist in the facilitation of quality care at the most effective cost."⁶

17 Microsoft, which became a customer of Premera in January 2003, made the following
18 observations about Premera's technology: "Premera's delivery of technology
19 solutions was fantastic." Tom McPherson, Microsoft manager of e-health. Recently
20 Microsoft awarded Premera a "Partnership and Service Excellence" award for its
21 exceptional performance as the software leader's health-benefits administrator. To

22 ⁶ "Premera Blue Cross Press Release, "GAO REPORT: TECHNOLOGY INVESTMENTS BY
23 PREMERA BLUE CROSS SAVE MILLIONS; IMPROVE SERVICE AND QUALITY OF CARE",
November 11, 2003, located at
24 https://www.premera.com/stellent/groups/public/documents/xcpproject/newsroom_11_11_2003.asp.

1 continue to meet Premera's mission and vision it will need to continue its investment
2 in technology to provide outstanding customer service.

3 **CONCLUSION OF TESTIMONY**

4 **Q. Does this conclude your testimony?**

5 **A. Yes.**
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VERIFICATION

I, ALAN SMIT, declare under penalty of perjury of the laws of the State of Washington that the foregoing answers are true and correct.

Dated this 29th day of March, 2004, at Seattle, Washington

_____/s/_____
ALAN SMIT

Gartner Dataquest

market intelligence

data

strategic

Gartner

Executive Summary

In Unforgiving Times, the U.S. Healthcare Market Boosts IT Spending, 2001-2006 (Executive Summary)

Executive Summary

Publication Date: 13 August 2003

Exhibit A

In Unforgiving Times, the U.S. Healthcare Market Boosts IT Spending, 2001-2006 (Executive Summary)

Overview

Day in and day out, U.S. healthcare organizations face daunting business pressures and difficult business decisions. To stay in business, healthcare executives must maneuver through a myriad of difficult challenges that include the following:

- Clinical pressures — Eliminate medical errors, ensure patient safety and improve medical outcomes
- Financial pressures — Attain or maintain profitability
- Strategic pressures — Develop and execute new business models
- Competitive pressures — Respond to competition from specialty hospitals, offer new medical services and respond to new patient demands
- Organizational pressures — Integrate acquisitions quickly and effectively
- Efficiency pressures — Reduce the high cost of delivering care and processing claims
- Internal management pressures — Address staff turnover and staff shortages
- Regulatory pressures — Comply with new regulations that arise frequently

Mistakes can be costly. Indeed, executives from organizations that fail to comply with the principles of the U.S. Health Insurance Portability and Accountability (HIPAA) may not only pay hefty fines; they may also serve jail time.

In this tumultuous environment, healthcare organizations need sound advice. Healthcare organizations are recognizing that, in addition to business and strategic advice, they need sound technology advice because IT can help or hinder their ability to address their business challenges. Indeed, most organizations have shifted their thinking from technology being the source of their problems to technology being the source of their solutions. Gartner Dataquest's IT spending forecast for the U.S. healthcare market reflects the increased strategic and tactical importance of IT in the healthcare market. As Figure 1 illustrates, Gartner Dataquest forecasts that the U.S. healthcare market will grow at a compound annual growth rate (CAGR) of 7 percent from \$34.1 billion in 2001 to \$47.9 billion in 2006.

Compared with other vertical markets in the United States, the healthcare market is the second-fastest-growing market for IT. Only the government market is growing faster. The relatively fast growth rate of the healthcare IT market can be attributed to its overall size, which is a fraction of the financial services and manufacturing IT markets. However, the growth rate can also be attributed to economic constraints that have stemmed growth of IT markets in other industries but have not had an impact on the healthcare market. Indeed, the direction of IT spending in the healthcare market is often countercyclical to that of other industries.